Attachment 3

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Managing Director & Principal

October 31, 2011

Dr. George Diehr
Chair of the Investment Committee
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Global Fixed Income – Annual Review and External Manager Contract Renewals[1]

Dear Dr. Diehr:

You requested Wilshire's opinion with respect to the Global Fixed Income Annual Program Review and Staff's proposal to extend the contracts of the existing external managers.

Overview and Recommendation

Global Fixed Income Staff manages a number of programs for CalPERS. For PERS, Wilshire believes that the Global Fixed Income Program uses an approach which is appropriate for CalPERS, given the long duration of the liabilities, the need for income, and the Investment Committee's desire for fixed income to act as a safe harbor in a portfolio dominated by Growth assets. Other PERS programs, such as Inflation-Linked Bonds, Commodities, the Liquidity Program, etc. are similarly well-managed. Staff also manages portfolios for various Affiliate Funds, the Securities Lending Program, and others.

Just over a year ago, Staff reduced the risk budget in the Global Fixed Income Program by approximately 50%. These heightened duration and sector constraints will make the portfolio more benchmark aware, but have not eliminated Staff's ability to add value.

[1] Wilshire's Code of Conduct requires us to disclose which of the above firms are clients of Wilshire's Analytics Services Division and as such pay Wilshire a fee for the licensing of analytical software used in investment management. Wilshire's consulting division has no business relationship with them. This disclosure has been delivered under separate cover.

Wilshire recommends that each of the external manager contracts be extended as requested by Staff.

Background

While there are many portfolios and Programs under the auspices of Global Fixed Income, we will focus our comments on the traditional fixed income portfolio for PERS. For that portfolio, the Global Fixed Income Program is designed to provide broad exposure to the U.S. bond market with a focus on investment grade securities. The Program also includes some secondary exposure to the high yield bond and leveraged loan markets, and the non-U.S. bond markets. Wilshire monitors and conducts annual reviews on each of the internal components (the dollar denominated program, the short duration investment funds, the securities lending program) and monitors and conducts regular ongoing due diligence on each of the external managers. While each of these components is critical, this agenda item allows Wilshire the chance to formally opine on the total program.

Internally Managed Portfolios

As we have noted in the past, we believe that the Global Fixed Income Program is an appropriate implementation approach for PERS. Given the fund's size and the high levels of active risk in AIM and Real Assets, a broad-based, long duration, yield-biased approach is prudent, effective and efficient. The yield-bias is primarily driven by an underweight to government bonds and commensurate overweights to the spread sectors (mortgages and other structured bonds, high quality corporate bonds, high yield bonds, etc.). Since CalPERS is a long-term investor, this approach is appropriate for the Global Fixed Income Program as a yield-biased approach typically outperforms over long periods of time. It should be noted that the yield bias has diminished as part of the reduction in active risk in the portfolio.

Nevertheless, the Global Fixed Income Program investment philosophy is not an all-weather approach and significant risks remain. If the spread sectors underperform – as they did in 2008 and so far in 2011 – a yield bias based on overweighting the spread sectors will suffer. If interest rates rise, the long duration nature of the portfolio could cause sizable market value declines.

Given CalPERS' asset size and staff size constraints, adding value solely through security selection is a challenge. The recent changes to sector and duration constraints force Staff to take less active risk in the fixed income portfolio than would have been permitted in prior periods. However, this reduction in active risk leads to a lower likelihood of a repeat of 2008's performance relative to the benchmark, when the portfolio's yield bias lead to significant underperformance during a very challenging market. The returns of the program over the last 12 months offer evidence of this relative risk reduction. As Staff notes, the portfolio has modestly underperformed - +8.5% versus +8.8%.

We have observed in prior annual reviews of the internally managed portions of the Global Fixed Income Program that additional staff would be needed as the complexity of the portfolio continues to grow. We are pleased to note that Staff has filled two Portfolio Manager positions and 6 Investment Officer positions. Staff is considering continued insourcing of other approaches, which may require additional resources in the long term. Staff has demonstrated the ability to add value by managing investment grade and high quality high yield portfolios internally. However, these activities are resource intensive and Wilshire recommends preserving current Staffing levels and adding to research functions as is deemed appropriate and fiscally sensible.

External Manager Contracts

Wilshire recommends that the Investment Committee renew each contract as Staff has proposed. We consider each manager to have the appropriate characteristics to remain one of CalPERS external managers – a stable organization, an appropriate and unique investment process, and returns that demonstrate a long term ability to add value to CalPERS' portfolio. As always, CalPERS has the right to terminate any of these managers on no more than 30 days notice, should the need arise. It is worth noting that some of the managers that Staff is requesting renewal for have been de-funded as a result of de-emphasizing high yield within the portfolio. Additionally, the time weighted returns for Artio appear abnormally low relative to the benchmark. Wilshire has discussed this with Staff and it is caused by the wind up of the portfolio and poor performance from a small handful of bonds that remained in the portfolio during liquidation. On a dollar weighted return basis or an IRR basis, the returns for Artio are more in line with the appropriate index.

Staff has provided manager return histories versus appropriate benchmarks. In the appendix of this letter, Wilshire has provided long term universe ranks for the managers[2]. The manager performance varies and each has been influenced by the recent returns and events in the markets. Generally, the performance of the external managers has been quite good relative to the universe of other similar managers.

Conclusion

Wilshire views the Global Fixed Income Program favorably. We continue to view the lower active risk approach as a prudent step in the overall evolution of CalPERS as the

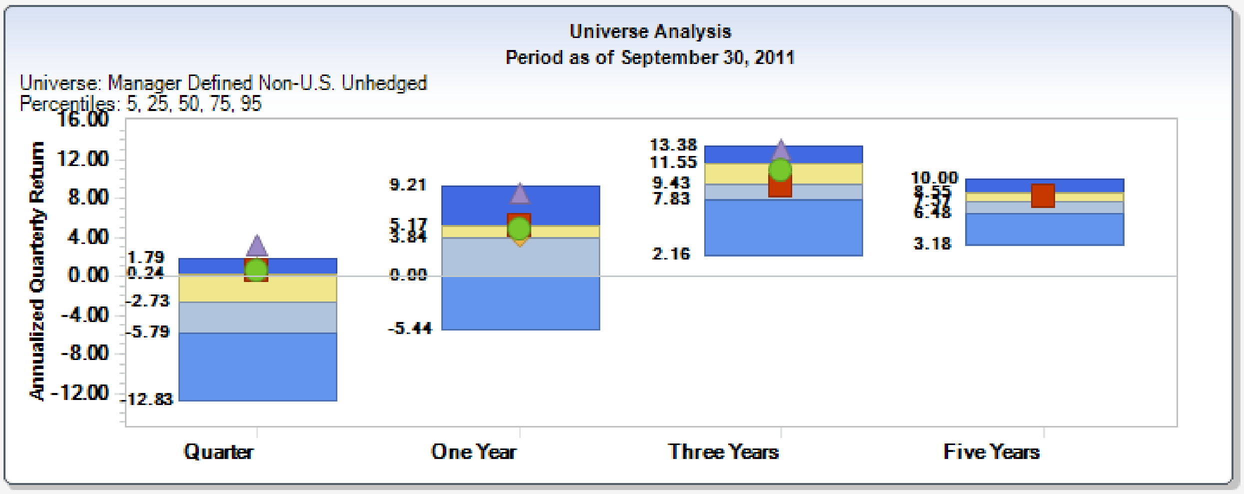
[2] Given the specialized nature of the B-rated and below high yield managers and the short track record for several of the other accounts, universe ranks are not provided for each manager.

total portfolio contains significant active risk in other programs. Wilshire recommends the extension of contracts for the current managers as part of the overall portfolio.

Should you require anything further or have any questions, please do not hesitate to contact us.

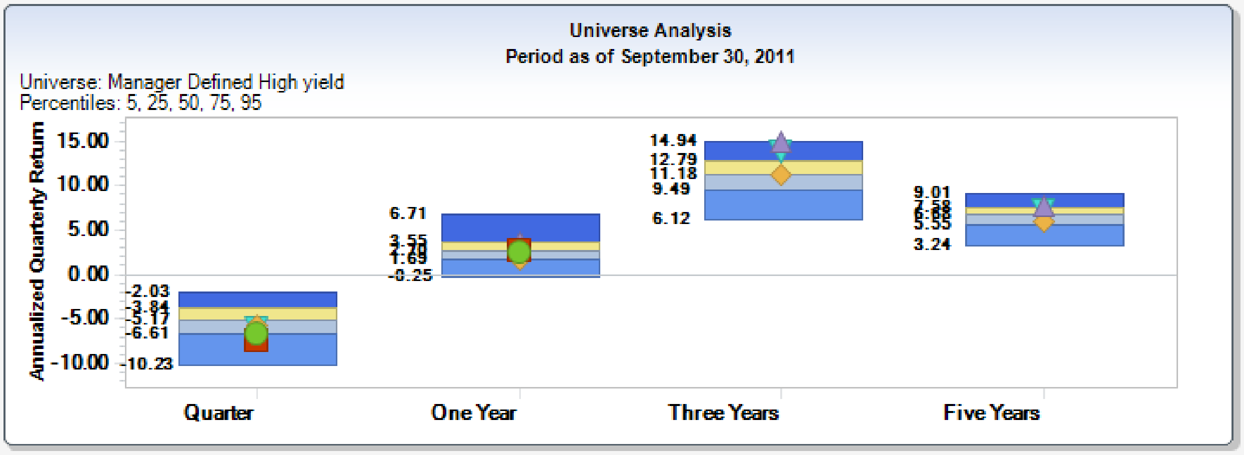
Best regards,

International Fixed Income Manager Universe Comparison



		Quarter	One Year	Three Years	Five Years
●	AllBernstein - Intl - CalPERS	0.50 (24%)	4.76 (34%)	10.79 (33%)	
■	Baring - Intl - CalPERS	0.56 (24%)	5.16 (25%)	9.31 (52%)	8.25 (30%)
▲	PIMCO - Intl - CalPERS	3.16 (1%)	8.46 (12%)	12.96 (8%)	
◆	Rogge - Intl - CalPERS	0.86 (15%)	4.06 (45%)	9.23 (53%)	8.20 (33%)
	# of Products	55	55	54	47

High Yield Manager Universe Comparison



		Quarter	One Year	Three Years	Five Years
●	Columbia HY - CALPERS	-6.66 (75%)	2.52 (57%)		
■	Logan Circle HY - CalPERS	-7.47 (85%)	2.74 (49%)		
▲	Nomura HY - CalPERS	-6.52 (73%)	3.68 (24%)	14.85 (6%)	7.76 (19%)
◆	PIMCO Hy - CalPERS	-5.80 (60%)	1.71 (75%)	11.28 (48%)	5.91 (67%)
▼	BC High Yield	-6.06 (65%)	1.79 (74%)	13.83 (14%)	7.08 (41%)
	# of Products	165	163	152	140

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